No. 7211

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

G. D. THOMPSON, As Receiver of the Twin Falls National Bank, Twin Falls, Idaho,

Appellant,

vs

COMMON SCHOOL DISTRICT NO. 54, in the County of Twin Falls, State of Idaho,

Appellee.

G. D. THOMPSON, As Receiver of the Twin Falls National Bank, Twin Falls, Idaho,

Appellant,

vs.

COMMON SCHOOL DISTRICTS NOS. 32, 36, 57, 59, and 62, in Twin Falls, County, State of Idaho,

Appellees.

BRIEF OF APPELLANT

Upon Appeal from the United States District Court for the District of Idaho, Southern Division

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FRANK L. STEPHAN,
J. H. BLANDFORD,
Solicitors for Appellant,
Residence: Twin Falls, Idaho.

MARLIN J. SWEELEY,
EVERETT M. SWEELEY,
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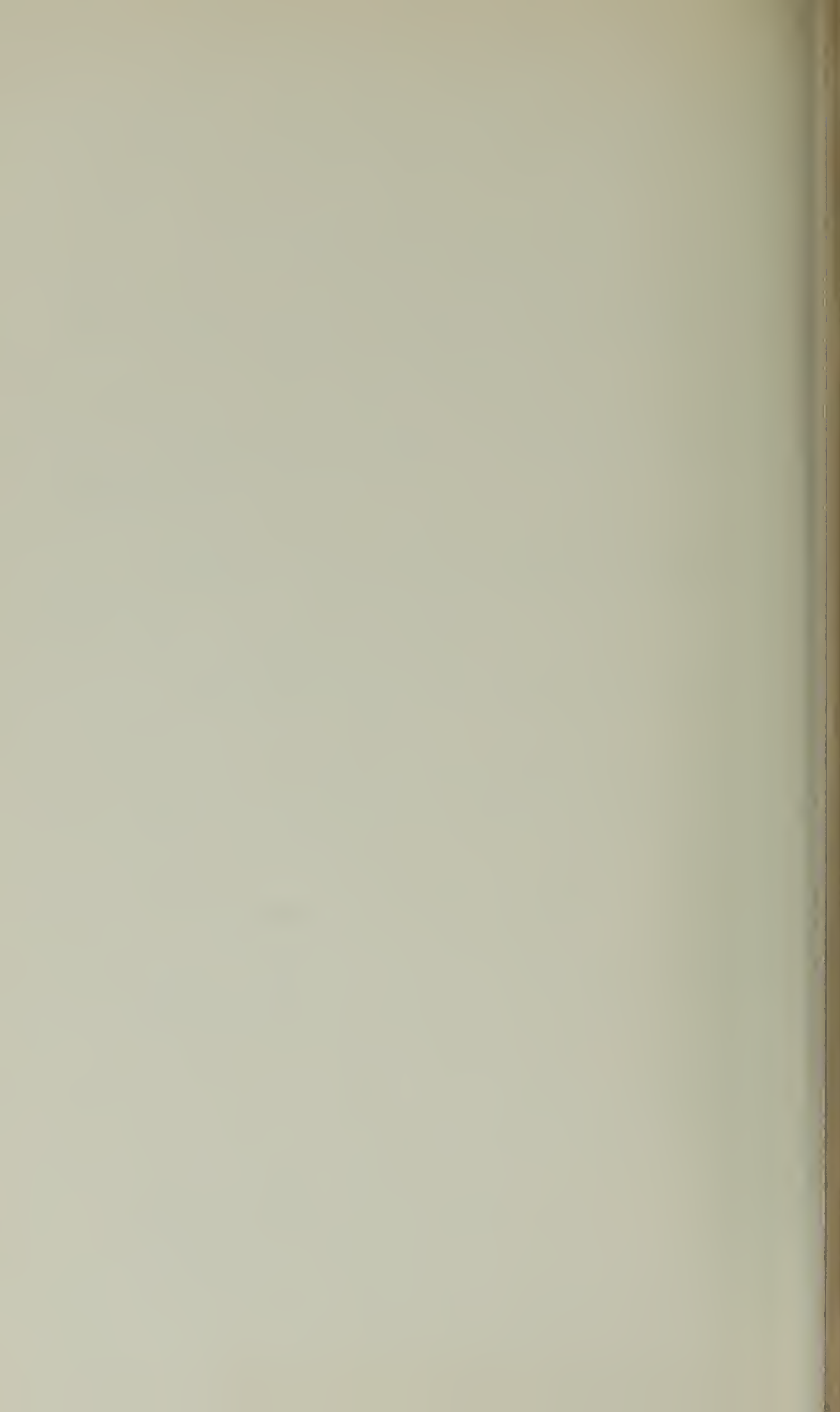

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STATEMENT OF FACTS

(Note: Figures in parentheses refer to numbers of pages in Transcript of the Record.)

During the year 1929 Twin Falls National Bank of Twin Falls, Idaho, in good faith, without notice of any irregularities, for valuable cash considerations purchased the forged orders for warrants

which are described in the pleadings and stipulations in the two cases involved in this appeal. Said orders purported in all respects to be genuine orders of the school districts and were directed to the Auditor of Twin Falls County. In each instance the Twin Falls National Bank presented the orders to the County Auditor and he in turn issued warrants drawn on the County Treasury in payment or redemption of the orders. The Bank then took the warrants to the County Treasurer who under the Idaho Law is Treasurer of the Common School Districts within his county, and the County Treasurer in turn redeemed the warrants by drawing and delivering to the Twin Falls National Bank his checks drawn on the Twin Falls Bank and Trust Company or the First National Bank, both of Twin Falls.

The amounts of the several orders involved in case No. 1787 are as follows; $160.00, $212.00, $160.00, $225.00, $225.00, $100.00, and $240.00, or an aggregate of $1322.00 (102, 104, 106, 108, 110, 112, 114). The warrants drawn by the County Auditor in payment of the orders in each instance except in the transaction set out in Count V exceeded the amounts of the several orders due to the fact that the warrants were in payment of the forged orders and other valid orders not in controversy in this case.

The checks delivered by the County Treasurer to the Twin Falls National Bank in payment of the warrants were not presented for payment in cash by the Twin Falls National Bank to the banks upon which they were drawn but were run through the clearing house in settlement of drafts and checks held by those banks against the Twin Falls National Bank.

In the transaction involved in Count I of the Complaint the balance of clearings was in favor of the Twin Falls National Bank and the First National Bank paid that difference by giving the Twin Falls National Bank a check drawn on the National Copper Bank of Salt Lake City in the amount of $774.04 which check the Twin Falls National Bank forwarded to the Federal Reserve Bank at Salt Lake City for collection and credit in the Federal Reserve Bank. (Stipulation 101-102).

In the transaction involved in Count II of the Complaint the balance of clearings was in favor of the Twin Falls National Bank and the Twin Falls Bank and Trust Company paid that balance by giving the Twin Falls National Bank its check drawn on Walker Bank and Trust Company of Salt Lake City in the amount of $2203.10, which check the Twin Falls National Bank forwarded to the Federal Reserve Bank for collection and credit in the Federal Reserve Bank. (104).

And in the transaction involved in Count VII the balance of the clearings was in favor of the Twin Falls National Bank and the First National Bank paid that balance by giving the Twin Falls National Bank its check drawn on National Copper Bank of Salt Lake City in the amount of $656.90, which check the Twin Falls National Bank forwarded to the Federal Reserve Bank for collection and credit in the Federal Reserve Bank. (114-115)

In each of the three foregoing instances the Federal Reserve Bank gave the Twin Falls National Bank credit for the checks forwarded to it. The Federal Reserve Bank did not send any part of the proceeds of the above described checks to the Twin

Falls National Bank but all of the credit built up in the Federal Reserve Bank by virtue of those remittances was exhausted by the payment of drafts drawn by the Twin Falls National Bank upon the Federal Reserve Bank and on November 2, 1931, a date long subsequent to the transactions involved herein, (116) the account of the Twin Falls National Bank in the Federal Reserve Bank was overdrawn.

The Twin Falls National Bank closed its doors November 23, 1931 and thereafter a Receiver was appointed by the Comptroller of the Currency to liquidate its business.

In each of the other four transactions involved in this action (Counts III, IV, V, and VI, Stipulation 106-113) the balance of clearings was against the Twin Falls National Bank and in each of those instances the check which the Twin Falls National Bank had received from the County Treasurer was used by that bank in settling accounts with a local bank of Twin Falls and in addition thereto the Twin Falls National Bank was compelled to pay a remaining balance by drawing its check upon the Continental National Bank of Salt Lake City.

No part of the proceeds of the seven checks drawn by the County Treasurer and delivered to the Twin Falls National Bank ever came into the custody or possession of the Twin Falls National Bank or into the hands of the Receiver of said Bank.

Sometime after the discovery of the forgeries of orders for warrants hereinabove described the school districts brought separate actions in the District Court of the Eleventh Judicial District of the State of Idaho in and for Twin Falls County against the Twin Falls National Bank and in each instance

recovered a judgment against the bank. (48-63).

The judgment obtained against the bank in each instance was for the amount of the forged order for warrant, together with interest thereon at the rate of 7 per cent per annum and costs of suit.

The amounts of the several judgments together with the costs aggregate $1610.37.

After the appointment of the Receiver, claims on the part of the School Districts were presented to and filed with the Receiver. In each instance the claims were for the amounts of the judgments procured in the State District Court.

Following the trial of the case in the United States District Court, Judge Cavanah gave the school districts judgment for the full amount of their claims filed with the receiver and ordered them to be paid in full prior to and in preference to the claims of the general creditors of said Bank.

Cases numbered 1729 and 1787 by leave of Court have been consolidated for the purpose of this appeal.

The issues involved in the two cases are similar. In case No. 1729 the forged order for warrant was in the amount of $290.00 When the Twin Falls National Bank presented the order to the County Auditor the County Auditor executed and delivered to it warrant numbered 28171 in the amount of $502.00 described in the Stipulation on Page 104 of the Transcript, hence, all of the facts necessary to a full and complete determination of Case No 1729 appear in the record of the case numbered 1787.

THE QUESTION RAISED

The issue in this case is whether the plaintiffs are

entitled to have their claims classified as preferred claims and have the funds now in the Receiver's custody impressed with trust characteristics and the claims of plaintiffs paid in full or whether they may be compelled to pro rate with other general creditors.

ARGUMENT.

The Act of Congress (U. S. C. A. Title 12, Sec. 194; R. S. Sec. 5236) which relates to the winding up of the business and affairs of insolvent national banks, provides among other things, that after full provision has been made for reimbursing the United States for advances in redeeming the circulating notes of the bank, the Comptroller of the Currency shall from time to time make ratable dividends to the creditors of the moneys paid over to him by the Receiver. The only preference recognized in the Act is the one given to the United States to make good the deficiency resulting from the redemption of the circulating notes of the bank. Any Balance remaining must then be ratably distributed among the general creditors. In the case of Cook County National Bank vs. United States, 107 U. S. 445, 2 Sup. Ct. 561, 27 L Ed. 537, Justice Field said:

> "The declaration considered in connection with the ratable distribution of the assets, prescribed after such deficiency is provided for, is equivalent to a declaration that no other priority in the distribution of the proceeds of the assets is to be claimed."

The requirement of equal distribution applies only

to assets which belong to the Bank and not to money or property which, although appearing to be the property of the Bank, actually belongs to others and hence the real owners of property or funds held by the Bank or its Receiver, subject to a trust, are not deprived of their right to recover in full the trust fund or so much thereof as can be traced.

Accordingly any person claiming a preference over the general creditors of an insolvent national bank must be prepared to show that there is among the listed assets of the insolvent bank in the hands of the Receiver certain property which is his property either in its original or substituted form. The equities, if any, which prefer or tend to prefer a creditor and allow his claim to be paid in full grow out of his rights in property. His claim must be based upon facts which expressly or impliedly raise or create a trust relationship.

The numerous decisions of the Federal Courts touching upon the ratable distribution of dividends from insolvent national banks are uniform in laying down the prerequisites to the establishment of a preferred claim against the Receiver of a National Bank.

I.

THE FOLLOWING ARE PREREQUISITES TO THE ESTABLISHMENT OF A PREFERRED CLAIM AGAINST AN INSOLVENT NATIONAL BANK:

1. THE FUNDS CLAIMED MUST BE IMPRESSED WITH A TRUST;

2. THE ASSETS OF THE BANK MUST HAVE

BEEN INCREASED OR AUGMENTED BY THE TRANSACTION IN WHICH THE FUND WAS INVOLVED;

3. THE CLAIMANT MUST ALSO BE ABLE TO TRACE THE FUNDS INTO THE HANDS OF THE RECEIVER AND THERE IDENTIFY THE SAME EITHER IN ITS ORIGINAL OR SUBSTITUTED FORM.

In this case the paintiffs did not voluntarily pay or deliver any of its money or property to the Bank as a fiduciary, hence, there was no express trust.

The facts of the case show that the bank purchased the orders for school warrants in good faith for valuable considerations and without notice that the orders were forged or fictitious and when the bank presented the orders to the County Auditor for redemption it did so in good faith and the Auditor in good faith, without knowledge or notice of any defects in the orders issued and delivered the warrants. Likewise, when the warrants were presented to the County Treasurer for payment or redemption that official acted in good faith. None of the acts on the part of the bank or the county officials, acting for the school districts, were tainted with fraud. Hence, the bank cannot be regarded as a trustee ex malefico and consequently only a debtor and creditor relationship has grown out of transactions involved herein.

One of the earliest cases and probably one of the most frequently cited in Federal Jurisdictions, is Beard v. Independent District of Pella City, 88 Fed. 375. In that case the Independent District of Pella City instituted an action against R. R. Beard, Re-

ceiver of the First National Bank of Pella City for the purpose of compelling the Receiver to recognize as a trust fund and pay in full the amount of a balance deposited by the Treasurer of the District. At Page 379 of the opinion, the Court said:

> "The foundation of the right on part of the owner of a trust fund to a preference over general creditors in payment out of a fund or estate that has passed to the assignee or receiver of an insolvent person or corporation is, that the trust fund has been wrongfully confused or intermingled with the property of the insolvent, or has been used to increase the value of the property thereby increasing the amount or value of the funds or estate passing into possession of the assignee or receiver; that, if this intermingling had not taken place, the fund passing to the receiver would have been so much less; that the creditors have only the right to subject the property of the debtor to the payment of their claims, and therefore the creditors cannot complain if the total fund coming into the hands of the receiver is reduced by the amount necessary to make good to the owner of the trust fund the sum which was wrongfully used in augmenting the fund or property passing to the receiver. Unless it appears that the fund or estate coming into possession of the receiver has been augmented or benefited by the wrongful use of the trust fund, no reason exists for giving the owner of the trust fund a preference over the general creditors, and this we understand to be the doctrine recognized by the

supreme court of Iowa and the supreme court of the United States alike. * * * It is open to the school district to assume the position occupied by its treasurer, and, by acknowledging his acts, become a creditor of the bank for the balance shown to be due to the school treasurer; but when the district attempts to avoid the position of a creditor, and to assume that of the owner of a trust fund, and as such to assert a preferential right to payment in full out of the cash fund coming into the hands of the receiver, to the deteriment of the general creditors, it ought to be held to satisfactory proof of the fact upon which the right to a preference rests, to-wit, that the fund coming into the receiver's hands has been augmented and increased by the addition thereto of the trust money, not as a matter of inference, nor as a result of mere entries on books of account, but because the fund or property against which the preference is sought to be enforced has been in fact augmented or benefited by the addition thereto of the trust fund."

In American Can Co. v. Williams, 178 Fed. 420 we find the following:

"The stipulation of facts merely states that the 'assets' of the bank prior to the receivership, and which came into the receiver's hands, exceeded the amount of the plaintiff's claim. No basis whatever is furnished for tracing the misappropriated moneys into the hands of the receiver, or for holding that they were convert-

ed into, or commingled with, any other property or funds in his possession. It is not shown what the assets of the bank consisted of. It may be that the only assets which the receiver obtained were notes and bills receivable—or, perhaps, its banking house—which belonged to the bank before the transactions in question took place. It may be that prior to the receivership the bank used the trust funds to pay its debts with. It may be that these funds were wholly dissipated. There is absolutely nothing to show that they had any connection with any of the property which came into the possession of the receiver. The stipulation of facts is wholly insufficient to show any identity of property followed with the funds sought to be charged against it or to show that the amount of such property was increased or augmented by such funds Indeed, the negative is not shown. It does not appear that if there had been no misappropriated moneys the assets of the bank would have been less.

"While the right to follow misapplied moneys as trust funds into the hands of a receiver has been extended in the modern decisions, there has never been in the federal courts a departure from the principle that there must be some identification of the property followed with the trust funds. Some of the latest cases say that it is sufficient to show that the property in the possession of the receiver has been increased or augmented by the trust funds. But that is only a different way of stating the earlier rule.

It cannot be shown that property in the hands of a receiver has been increased by trust funds unless it is shown that they were converted into or commingled with it."

In the case of Larabee Flour Mills vs. First National Bank, 13 Fed. (2nd) 330 the Court said:

"The real issue in each case is between the preference claimant and general creditors of the bank. They will get less if the preference is allowed. Each claimant asserted an equity, that the assets taken over by the Comptroller are trust funds in which it is a preferred beneficiary. It is difficult to explain or understand by what equitable right one who has not contributed to the creation of a fund should be given a special and superior interest therein, though some of the state Courts seem to so hold. The collecting banks acted as agents, Commercial Bank v. Armstrong, 148 U. S. 50, 13 S Ct. 533, 37 L. Ed. 363, and had they collected and retained the funds called for by the drafts, as was their duty on account of insolvency, the equities of claimants would be plain; but instead of doing so they merely shifted credits on their books and records. No part of the funds in the banks when they failed was placed there by claimants or by any one for them. In each case the draft was paid by check on the insolvent. No additional funds were brought into the bank by either transaction. If the drafts which they held for collection had been paid in currency or by check on some other bank, the

insolvents' assets would have been increased that much when thereafter their remittance drafts were dishonored; and in that event equity would have regarded the collections as trust funds, followed them into the increased assets and, to the extent of the increase applied them first in discharge of these claims. This is our conception of the rule and the reason for it, applied in the federal courts."

To like effect is the decision in the case of Hirning v. Federal Reserve Bank of Minneapolis, 52 Fed. (2nd) 382.

INTEREST AND COURT COSTS.

As shown by plaintiffs' complaint in this case, their claims which were filed with the Receiver were based not on the orders for warrants, or warrants or upon the County Treasurer's checks given to the Bank, but upon the Judgments which they had obtained in the actions which they prosecuted in the District Court of Twin Falls County, Idaho. Each judgment was for the amount of the order for warrant, plus interest and court costs. The several orders aggregate $1322.00 The amounts of the several judgments based on those orders aggregate $1610.37. The difference is interest and costs. (See Statement of Facts in this Brief).

Upon no theory of the law applicable to a "trust" claim may plaintiffs have a preferred claim for interest and costs. Those items are not trust property, are not traceable to the funds of the bank, nor can they be regarded as having augmented the assets of the bank. Plaintiffs' claims to that extent are

wholly inconsistent with the trust fund doctrine upon which plaintiffs must predicate their claims for recovery And furthermore, the fact that the school districts sought and obtained judgments for interest negatives the notion of a trust relationship. See McNulta v. West Chicago Park Commissioners, 99 Fed. 900, wherein the Court said:

> "A deposit upon which interest must be paid cannot be special or in trust, and, in case of the failure of the bank, must, for the purpose of payment, be on the same footing with other deposits or unsecured demands."

In the case of White v. Knox, 111 U. S. 784, 4 Sup. Ct. 686, 28 L. Ed. 603, Mr Chief Justice Waite said:

> "The only claims the Comptroller can recognize in the settlement of the affairs of the bank are those which are shown, by proof satisfactory to him, or by the adjudication of a competent Court, to have had their origin in something done before the insolvency. It is clearly his duty, therefore, in paying dividends, to take the value of the claim at that time as the basis of distribution. If interest is added on one claim after that date, before percentage of dividend is calculated, it should be upon all, otherwise the distribution would be according to different rules, and not ratably, as the law requires."

See also Merchants National Bank of Helena, Montana, vs. School District No. 8 of Meagher County, 94 Fed. 705, Pages 708-9.

II

TRACING FUNDS INTO THE GENERAL ASSETS OF THE BANK IS NOT SUFFICIENT TO ENTITLE PLAINTIFFS TO A PREFERINTIAL CLAIM.

It is freely admitted by the defendant in this action that the Twin Falls National Bank obtained checks from the County Treasurer in payment of warrants which had been issued and delivered by the County Auditor in redemption of the forged Orders. It may with propriety be argued by the plaintiffs that the checks drawn by the County Treasurer when delivered to the Twin Falls National Bank increased generally the assets of the Twin Falls National Bank. But inasmuch as no funds ever came into the custody or possession of the bank or the Receiver as a result of the several transactions, plaintiffs are not entitled to a preferential claim.

In the case of State Bank of Winfield v. Alva Security Bank, 232 Fed. 847, the plaintiffs sought to hold the defendant banks for funds resulting from the sale by the Cashier of one of the banks of forged notes to the plaintiffs, and in its opinion the Court said:

> "The trial Court was right. The plaintiffs wholly failed to trace the funds after they passed from their hands. Their only attempt to do so consisted of unconvincing evidence combined with an erroneous legal theory. * * * The drafts themselves were not produced, nor was any attempt made to identify the account in which

they were deposited or to show the state of the account between the time of the deposit and the date of the bank's failure. * * * The capital defect, however, of the plaintiffs' theory is their treatment of the grand division of the bank's assets in those respects known as 'Cash and Sight Exchange' as the fund within the law relating to the following of trust funds. To adopt that theory is to re-establish under a mere bookkeeping disguise the exploded notion that a trust fund may be recovered if it can be traced into the general assets of an insolvent bank. The courts have shown a trend to restrict the 'trust funds' doctrine."

In the case of Macy v. Roedenbeck, 227 Fed. 346, the Court recognizing the same rule said:

"The modern and more equitable doctrine permits the recovery of a trust fund from one not an innocent purchaser, and into any shape into which it may have been transmuted, provided he can establish the fact that it is his property or that his property has gone into it and remains in a mass from which it cannot be distinguished."

And the Court further says:

"We recognize the rule only permits the following of the converted property into assets which can be traced as proceeds, and that the lien does not attach to assets in which neither the thing nor its value can be found."

And concluding, the Court in the same opinion further says:

> "There is no pretense in the record that the claimant traced his funds into any assets, either in cash or property, in which said funds were invested, in the hands of the trustee, other than the sum of $426.70 in cash, remaining in the bank upon the date the petition in bankruptcy was filed, and which came into the hands of the Receiver. It appears affirmatively that proceeds of the claimant's collection cannot be found in any of the assets in the hands of the trustee, other than the cash above mentioned."

The case of Board of Commissioners v. Strong, 157 Fed. 49 has been cited in numerous cases as anthority on the Trust Fund Doctrine. That case approves the rule announced in Knatchbull v. Hallett, 13 Ch. Div. 696, which will be later referred to in this Brief. The Court recognizes the principle that tracing funds into the general assets of the bank is not sufficient to entitle the claimant to be preferred over the general creditors. We quote from pages 51 and 52 of the opinion:

> "This side of the rule is peculiarly sound when it is sought to obtain an advantage in the distribution of the assets of an insolvent national bank. So long as the claim to advantage is bottomed upon the fact that the Receiver has received money or property into which the money of the claimant is shown to have gone the equity is a strong one, and, to the extent that the assets which have come into the hands of the re-

ceiver are shown to have been augmented by the receipt of the trust fund or its actual proceeds, other creditors should not complain if that is returned to which neither the bank nor its receiver had any just title.

"The equitable principles applicable to the facts of this case must operate to deny any general charge upon either the money or other assets of the bank in possession of the receiver, and deny complainants relief in respect of the moneys in the vaults of the bank when it closed, except insofar as the county has shown, aided by the presumption as to the money used in drawings from the general fund with which the trust fund was blended, that its money has come into the possession of the receiver."

On Page 54 of the opinion the Court further says:

"That the misuse of this trust fund has gone to swell, in one form or another, the general assets of the bank is not sufficient to charge the whole with a lien, will not be seriously contested. The cases which deny such a contention are numerous. To impress a trust upon the property of a tort-feasor who has used the trust fund in his private assets, it must be traced in its original shape or substituted form. (Citing cases) * * * In other courts the question has been presented more squarely for a decision, and supports the rule that an identification of the fund itself, or a tracing into some specific property, is essential to reach the property of a wrong-doer, either in the hands of an as-

signee, trustee, receiver or under a lien fastened by a creditor."

The same rule is recognized in the case of Empire State Surety Company v. Carroll County, 194 Fed. 593. In that case the Court said:

> "It is not sufficient to prove that the trust property or its proceeds went into the general assets of the insolvent estate and increased the amount and the value thereof which came to the hands of the receiver."

See also Cuttell v. Fluent, 51 Fed (2nd) 974.

III.

IN ORDER FOR PLAINTIFFS TO ESTABLISH THEIR RIGHT TO PREFERENTIAL PAYMENT OUT OF THE ASSETS OF THE INSOLVENT BANK IT WAS INCUMBENT UPON THEM TO PROVE THAT THE TRUST PROPERTY OR ITS PROCEEDS WENT INTO A SPECIFIC FUND OR INTO A SPECIFIC IDENTIFIABLE PIECE OF PROPERTY WHICH CAME INTO THE HANDS OF THE RECEIVER.

As heretofore pointed out in the transactions set out in Counts III, IV, V and VI (See Stipulation 106-114 Inc.) the balance of the clearings was against the Twin Falls National Bank; only in three of the transactions (See Stipulation 101-106; 114-117) were the balances in favor of the Twin Falls National Bank and the checks which were received from the local banks in making the clearings on those occasions were forwarded to the Federal Re-

serve Bank at Salt Lake City and no money was ever actually received by the Twin Falls National Bank or the Receiver, as a result of those transactions. The entire balance of the Twin Falls National Bank in the Federal Reserve Bank was applied to the payment of drafts drawn by the Twin Falls National Bank upon its account in the Federal Reserve Bank and on November 2nd, 1931, a date considerably later than the transactions involved in this suit the account of the Twin Falls National Bank with the Federal Reserve Bank was overdrawn. The proceeds of the three checks received from the two local banks of Twin Falls in settlement of the balance of clearings were consumed in satisfying the obligations of the Twin Falls National Bank and the transactions in question did not in any sense result in increasing the assets of the bank which were available for distrubution among the creditors.

And likewise, in the four instances, where the balance of clearings was against the Twin Falls National Bank, the four checks were used in balancing accounts or in other words in reducing its indebtedness or liability prior to insolvency, but that fact does not entitle plaintiffs to a lien on the assets of the bank which have come into the hands of the Receiver.

In the case of Dickson v. First National Bank of Buffalo, Oklahoma, 26 Fed. (2nd.) 411, wherein a similar question was raised, the Court in its opinion stated the rule applicable to the tracing of funds in the following language:

> "But even if the plaintiff's position were sustained in this respect by the authorities, he would

not be entitled to a preference for another reason. When the two checks in question were presented by the defendant bank to the Central State Bank of Buffalo, the accounts of these two institutions were adjusted and the balance was given to the defendant in the form of a draft. This draft was forwarded to the Federal Reserve Bank at Kansas City and deposited to the credit of the defendant. The entire balance of the defendant bank in the Federal Reserve Bank was applied on its indebtedness to the Federal Reserve Bank. So that the proceeds of these two checks were consumed in satisfying defendent bank's obligations to the Central State Bank of Buffalo and the Federal Reserve Bank at Kansas City. The ultimate result was that the indebtedness of the defendant bank was decreased to the amount of these two checks. The transaction did not in any sense result in increasing the assets of the bank which were available for distribution to creditors. To grant plaintiff a preference would not be to authorize him to take from the assets something which rightfully belonged to him by reason of his property being wrongfully added to the assets, but it would be to permit him to take from the assets funds which belong to other creditors. Since plaintiff contributed nothing to the assets of the defendant bank, when the failure came, no portion of his funds went into the receiver's hands. The same situation has frequently been presented to this court. In the Empire State Surety Co. v. Carroll County, 194 Fed. 593, it was said:

" 'It is indispensable to the maintenance by a cestui que trust of a claim to preferential payment by a Receiver out of the proceeds of the estate of an insolvent that clear proof be made that the trust property or its proceeds went into a specific fund or into a specific identified piece of property which came to the hands of the receiver, and then the claim can be sustained to that fund or property only and only to the extent that the trust property or its proceeds went into it. It is not sufficient to prove that the trust property or its proceeds went into the general assets of the insolvent estate and increased the amount and the value thereof which came to the hands of the receiver' "

In the case of Farmers National Bank v. Pribble, 15 Fed. (2nd) 175, the Court said:

"The doctrine that a cestui que trust whose property has helped to swell the general assets of a corporation which was or became insolvent, has a prior right or interest in those general assets, without specific identification and tracing of such claimant's property, was again expressly repudiated by this Court in the case last cited. (Referring to Mechanics' and Metals National Bank v. Buchannan, 12 Fed. (2nd) 891)."

And the Court further said:

"The fact that the claimant's property paid or reduced the indebtedness or liability of the insolvent corporation, so that it will pay a

larger percentage of its debts justifies no lien on its assets by or preference in payment to the cestui que trust (1) because such a reduction of the indebtedness does not increase the property or the value of the property of the insolvent; and (2) because the property of the claimant so used to pay a part of the insolvent's general indebtedness or liability never goes into, and therefore cannot be traced into, the property or assets of the insolvent which subsequently came into the possession of the Receiver. (Cases cited)."

In the case of Commercial National Bank v. Armstrong, 39 Fed. 684, at Page 692, the Court said:

"In seeking to follow and impress a trust character upon funds which an agent has misapplied, it is incumbent upon the principal to clearly trace such funds into the hands of the party against whom relief is sought; and so long as the trust fund or property, in either its original or substituted form, can be traced and identified, it may be followed and recovered by the true owner, provided it has not come into the possession of some bona fide holder for value without notice. This right of the principal 'only ceases when the means of ascertainment fails,' or when his property or funds has reached a bona fide holder for value, and without notice of the trust. * * * No well considered case has gone to the extent of holding that when an agent converts or misapplies his principal's property or money and thereafter fails, his general estate will be impressed with a trust

> for the reimbursement of such principal, on the ground that such estate has been benefited, and to an equal amount, by the agent's breach of duty. Every creditor could raise a like claim to priority of satisfaction on the same ground. The right of the owner to follow and recover his property rests upon a principle altogether different."

The decision in the foregoing case was affirmed by the Supreme Court of the United States in 148 U. S. 50, 13 Sup. Ct. Rep. 533, 37 L. Ed. 363.

Schuyler v Littlefield, 232 U. S. 707, 34 Sup. Ct. 466, 58 L. Ed. 806, was a proceeding by the plaintiffs to recover trust funds which they claimed they traced into the possession of the trustee in bankruptcy. Relative to the burden of proof in such cases and the tracing of trust funds the Court there said:

> "It would serve no useful purpose to make a detailed statement of the testimony. The evidence has been fully discussed by the court of appeals (113 C. C. A. 348-357, 193 Fed. 24-33) in considering this claim of appellants along with that of several other parties seeking, on somewhat similar facts, to trace trust funds into the bank, and thence into collateral which ultimately came into the hands of the trustee. All these claims were disallowed because of the failure to make the requisite proof. Our investigation of the facts leads us to the same conclusion so far as concerns the appellants' claim. They were practically asserting title to $9,600,

said to have been traced into stock in the possession of the trustee. Like all other persons similarly situated, they were under the burden of proving their title. If they were unable to carry the burden of identifying the fund as representing the proceeds of their Interborough stock, their claim must fail. If their evidence left the matter of identification in doubt, the doubt must be resolved in favor of the trustee, who represents all of the creditors of Brown & Company, some of whom appear to have suffered in the same way. Like them, the appellants must be remitted to the general fund."

This Court in the case of United States National Bank of Centralia v. City of Centralia, 240 Fed. 93, recognizes the rule that it was incumbent upon one seeking to reclaim trust property from a Receiver to trace the trust property or its proceeds into a specific fund or into a specific identifiable piece of property in the hands of the Receiver. We quote from Pages 95 and 96 of the opinion:

"The law impresses a trust upon funds so misapplied, and to the extent that the money, or any portion thereof, either in its original or a substituted form, can be traced into the funds which came into the possession of the Receiver, the appellee is entitled to a preference over the general creditors. (Cases cited).

"But it does not appear from the evidence that any of the appellee's money or any property into which it was transmuted, ever came

into the possession of the Centralia Bank, or was in the possession of any of its reserve Banks or other Banks, at the time when the Centralia Bank closed its doors. It is shown that $35,000 of the amount so placed to the credit of the Centralia Bank in the Seattle Bank was transferred from the Seattle Bank to the Centralia Bank's credit in the Bank of California of Tacoma, a reserve agent of the Centralia Bank; but it also appears that thereafter, on July 22d, the account of the Centralia Bank with the Tacoma Bank was overdrawn by $11,423.69 and it is not shown that any of said money came into the Centralia Bank. Between July 13th and July 28th the total of the deposits of the Centralia Bank with the Seattle Bank, including the appellee's money, was $184,102.01. The credit so established was exhausted by the transfer of money to the Bank of California of Tacoma, as above noted, by the transfer of about $20,000 to the Continental Bank of Chicago, a reserve agent of the Centralia Bank, by drafts drawn by the Centralia Bank in favor of its creditors on its account with the Seattle Bank, by the cashing of checks at the Seattle Bank drawn on the Centralia Bank by depositors of that bank, by the Seattle Bank charging to the Centralia Bank certain discount notes, which were either charged to accounts of depositors of the Centralia Bank or were exchanged for renewal notes taken by the Centralia Bank and rediscounted by it with other banks. But none of the appellee's money so deposited in the Seattle Bank is shown to have gone from

> that Bank back to the Centralia Bank, or to be traceable into any fund that came into the Receiver's hands"

A similar issue was involved in the case of Cuttell v. Fluent, 51 Fed. (2nd) 974. The Court there said:

> "The trust relationship having been established, the depositor may recover such fund or any part thereof insofar as the same can be traced in the possession of the Bank either in its original form or in forms to which it has been converted, or into a general fund with which it has been commingled. It is not sufficient for a cestui que trust to prove that the trust property or its proceeds went into the general assets of the insolvent estate and increased the amount and the value thereof and that these assets came into the hands of the Receiver. Although the draft belonged to the Bank, it was a general asset only. No segregation of the draft or its proceeds from the general fund or assets of the Bank had taken place. Here, then, the Administrator to recover must show that the proceeds from the draft directly or by substitution were commingled at some time with the cash fund of the bank which came into the hands of the Receiver. (Cases cited) The record is barren of evidence that any proceeds of the draft, directly or by substitution, at any time were commingled with the cash fund."

Again, on Page 977 of the opinion the Court said:

> "The clear proof is that the draft was sent

> to a reserve or a correspondent Bank and may there have been converted into cash. But the tracing of the draft or its proceeds to the correspondent Bank availeth nothing to claimant, as that fund was depleted and overdrawn prior to the time the Bank was taken over by the Comptroller of the Currency."

The latter part of the foregoing excerpt is particularly applicable to the transactions involved in this case wherein the Twin Falls National Bank forwarded the checks received from the other two local banks of Twin Falls to the Federal Reserve Bank of Salt Lake City for collection and credit.

In the case of Sanders v Stevens, 51 Fed. (2nd) 743 the Court on Page 745 of its opinion stated:

> "The further suggestion is made that plaintiff's demand has the elements of a preference claim, in that a reduction in the First National Bank's indebtedness to the Memphis Bank decreased the total of the outstanding claims, and thereby, in effect, increased the value to the general creditors of the assets of the defunct Bank. Several considerations repel this suggestion. First, it seeks to impress a lien upon assets in the hands of the Receiver not because they have been augmented by funds of the plaintiff, but because the total indebtedness of the bank has been reduced and the liabilities of the Receiver diminished, when there is nothing in the record to indicate what any of those amounts are now or were at any time. Second, to supply the missing proof would not change the result, because, since it does not appear that

> any part of the indebtedness to the Memphis Bank was secured by collateral which was surrendered or otherwise, the suggestion would substitute priority for equality to the extent of $1,134.06. * * * Third, and without reference to either of the two preceding reasons, no statute authorizes such a preference, and the equitable doctrine of following trust funds has never been extended to such lengths. On the contrary the proposition has been definitely repudiated. (Cases Cited)."

See also Titlow v. McCormick, 236 Fed. 209; and Dixon v. Hopkins, 56 Fed. (2nd) 783.

IV.

A PERSON CLAIMING A TRUST FUND MUST TRACE IT INTO THE HANDS OF THE RECEIVER OF THE INSOLVENT BANK AND WHERE THE EVIDENCE SHOWS THAT THE FUNDS HAVE BEEN DISSIPATED BY PAYING DEBTS OF THE FAILING BANK PRIOR TO THE RECEIVERSHIP, THERE CAN BE NO PREFERENCE IN THE FUNDS COMING INTO THE HANDS OF THE RECEIVER.

The right of a creditor to pursue and reclaim funds in the hands of a Receiver in charge of a National Bank must rest upon his right of property in said fund. The fundamental principle upon which this right is based is that the property in equity belongs to him and that he has the right to reclaim it. It is not based upon any relationship of debtor and creditor nor upon a debt due and owing,

nor does it rest upon the ground of compensation for the loss of property or fund, nor is it based on the theory of a preference arising by reason of the nature of the claim or the unlawful conversion of the property. A preference can only exist where the title to the property has not passed It is really not a question of preferring one creditor of the Bank over another, or another set of creditors, it is a question of the right of a claimant to recover property to which he holds title. If the claimant is to be permitted to follow and recover his property it must be because he owns it either in its original or in its substituted form. So long as a claimant can trace and identify his property he may reclaim it. But when the means of ascertainment fails the trust fails and when the property has been dissipated there is no reason or logic in allowing him to take the property of another.

In four of the transactions involved in this case the balance of clearings was against the Twin Falls National Bank; the checks which the Bank had received from the County Treasurer, together with other checks having been used in the clearings with the local banks of Twin Falls and consequently no money was received in exchange for the checks. The checks were used to discharge the obligations of the Bank.

It appears to be well-established by a great majority of decisions that where a trust fund is used by an insolvent bank to pay its own debts or to reduce its liabilities the right of a cestui que trust to follow the funds into the hands of the bank's receiver is defeated since such use of the funds amounts only

to a dissipation thereof rather than an augmentation of the assets in the Receiver's hands.

Many cases involving similar issues growing out of the liquidation of National Banks have been presented to the Federal Courts and as a consequence the rules applicable to this type of question seem too well established to admit of any doubt. The rules which are now so generally adhered to, especially by the Federal Courts, are the rules which were first announced in the celebrated English case In Re Hallett's Estate (Knatchbull v. Hallett) 13 Ch. Div. 696. The Supreme Court of the United States has approved the rules laid down in that case in Central National Bank of Baltimore v. Connecticut Mutual Life Insurance Co., 104 U. S. 54, 26 L. Ed. 693. The Circuit Court of Appeals of the Ninth Circuit has likewise approved the doctrine announced In Re Hallett's Estate in its opinion written by Judge Gilbert in the case of Spokane County v. First National Bank of Spokane, 68 Fed. 979. In that case Judge Gilbert said, quoting from Pages 980-981:

> "There is no recognized ground upon which equity can pursue a fund and impose upon it the character of a trust, except upon the theory that the money is still the property of the plaintiff. If he is permitted to follow it and recover it, it is because it is his own, whether in the form in which he parted with its possession, or in a substituted form. Under the earlier rule, he was required to identify it as the very property which he had confided to another. * * *
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> The more recent doctrine, however, follows the rule announced in Re Hallett's Estate (Knatch-

> bull v. Hallett) 13 Ch. Div. 696, which is that, if money held by one in a fiduciary character has been paid by him to his account at his banker's, the person for whom he held the money can follow it, and has a charge on the balance in the banker's hands, and that if the depositor has commingled it with his own funds at the bank, and has afterwards drawn out sums upon checks in the ordinary manner, he must be held to have drawn out his own money in preference to the trust money, and that if he destroyed the trust fund 'by dissipating it altogether, there remains nothing to be the subject of the trust, but so long as the trust property can be traced and followed into other property into which it has been converted, that remains subject to the trust.'"

In the same opinion while considering the right of a claimant to impress the estate of the insolvent with trust features, after the trust fund has been dissipated Judge Gilbert said:

> "We are unable to assent to the proposition that, because a trust fund has been used by the insolvent in the course of his business, the general creditors of the estate are by that amount benefited, and that therefore equitable considerations require that the owner of the trust fund be paid out of the estate to their postponement or exclusion. If the trust fund has been dissipated in the transaction of the business before insolvency, it will be impossible to demonstrate that the estate has been thereby increased or better prepared to meet the demands of

creditors, and even if it is proven that the trust fund has been but recently disbursed, and has been used to pay debts that otherwise would be claims against the estate, there would be manifest inequity in requiring that the money so paid out should be refunded out of the assets, for in so doing the general creditors whose demands remain unpaid are in effect contributing to the payment of the creditors whose demands have been extinguished by the trust fund. Both the settled principles of equity and the weight of authority sustain the view that the plaintiff's right to establish his trust and recover his fund must depend upon his ability to prove that his property is in its original or a substituted form in the hands of the defendant. (Cases cited)."

In the case of Anadarko Cotton Oil Co. v. Litteer, 300 Fed. 222 the Court said:

"Plaintiffs right to a preference in the funds in the hands of the receiver rests upon the theory that the funds in the hands of the receiver are trust funds, not belonging to the general assets of the bank, and it is incumbent upon the plaintiff to trace such funds into the hands of the receiver. I think the plaintiff has failed to sustain the burden of proof in this respect. The proceeds of the draft drawn on Buffalo, New York did not at any time come into the possession of the State National Bank, and were not among its funds on hand when it went into the hands of the receiver. The draft drawn on

Buffalo, New York, was sent to the Commerce Trust Company, and the proceeds used in paying other drafts drawn by the State National Bank, and particularly one drawn in favor of the Fort Worth bank for the $11,000.00. None of the funds at any time found their way back to the State National Bank of Ardmore. * * * At that time, then, the trust funds, if the same ever existed, had been dissipated in paying debts of the State National Bank, and none of the same had come into the possession of the Ardmore bank. Under this state of facts, I know of no rule of law which would give to the plaintiff a preference in the hands of the receiver, and the authorities cited by counsel for plaintiff do not appear to support a right of recovery. It appears to me the rule is well established that the person claiming a trust fund must trace it into the hands of the receiver and that if the evidence shows that the trust funds have been dissipated, even in paying debts of the failing bank, prior to receivership, there can be no preference in the funds coming into the hands of the receiver."

In the case of First National Bank of Ventura v. Williams, 15 Fed. (2nd) 585, at page 588 of the opinion we find the following statement of the law:

"Counsel for complainant insists that, but for the labor saving device of clearing by the exchange of checks, this check would have been collected in cash and the cash which came into the hands of the receiver would have been aug-

mented as a result thereof, and that the fact that the clearance was resorted to should not be allowed to deprive him of the advantage which he would have had under a cash collection. The answer to this is that courts must decide cases, not upon suppositions, but upon facts as proven or admitted, and the admitted fact is that cash was not received for the check but that it was used merely to reduce the liabilities of the bank. * * * For the reasons stated I do not think complainant is entitled to have a trust impressed on the cash which came into the hands of the receiver or any preference over the general creditors of the bank but is entitled to prove merely as a general creditor."

In the case of Marshburn v. Williams, 15 Fed. (2nd) 589 the Court said:

> "For the reasons stated in the opinion in the case of First National Bank of Ventura v. Williams (D. C.) 15 Federal 2nd 585 decided this term, and upon the authority of the cases therein cited, it seems clear to me that complainant has failed to trace the proceeds of the bonds into any fund which came into the hands of the receiver, and is not entitled to have a trust declared in his favor but is entitled merely to prove a claim as a general creditor."

Judge Taft while on the Circuit Court of Appeals in the Sixth Circuit wrote the opinion of the Court in the case of City Bank v. Blackmore, 75 Fed. 771. The Syllabus in the case is as follows:

"Plaintiff bank sent a New York draft to the City Bank to be deposited to plaintiff's credit; and the City Bank, which was insolvent, sent the draft to the National Bank, in New York, to be deposited to its credit. The National Bank applied the draft to reduce a debt due it by the City Bank, the draft being paid by the drawees, after some delay, under express directions from plaintiff. Held, that plaintiff was not entitled to payment of the amount of the draft by the receiver of the City Bank as a preferred claim, the amount of the assets for distribution among creditors not having been increased in that amount by the deposit of the draft."

In the body of his opinion Judge Taft said as follows:

"No authority has been cited to show that a claim founded on fraud is entitled to a priority over other claims. It is only where, by the rescission of the contract out of which the claim arises, on the ground of fraud, the specific thing parted with or its proceeds can be sufficiently identified to be returned, that fraud seems to give a priority of distribution. It may not be necessary to show earmarks upon the proceeds of the thing parted with to justify such a remedy, but it must at least appear that the funds in the hands of the receiver were increased or benefited by the proceeds, and the recovery is limited to the extent of this increase or benefit."

In the case of Dudley v. Richards, 18 Fed. (2nd)

876, the plaintiff had left certain bonds in a national bank for safekeeping and the bank wrongfully converted them by depositing them, together with other bonds, with the State Treasurer to secure a deposit of public funds. After the Bank closed the State Treasurer sold all of the bonds to satisfy his claim. The plaintiff claimed a preference and demanded payment in full, contending that by virtue of the trust fund doctrine his claim should be preferred. The Court said on page 878 of the opinion:

> "The recovery was evidently sought and obtained upon the theory that a claimed sum may be recovered as a trust fund if it can be traced into the general balance of the assets over liabilities of an insolvent estate. In State Bank of Winfield v. Alva Security Bank et al 232 F. 847, this court pronounced that theory an 'exploded notion.' It has been expressly and consistently repudiated in this Circuit in a great number of cases. * * *
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> " * * *
>
> "It will be noted that no money, as the proceeds of these bonds, came into the hands of the bank prior to the receivership. It is true that the bonds themselves were received by the bank, and by it delivered to the State Treasurer, as security for the general deposits made by that officer; thus they were converted; but the funds of the bank were not thereby augmented. The theory of augmentation is apparently based upon the fact that the indebtedness of the bank to the state as its depositor was discharged by the proceeds of sale of these and other bonds delivered as security for such deposit."

The Court then quotes from the opinion by Judge Sanborn in the Pribble Case cited elsewhere in this Brief.

In the case of Empire State Surety Company v. Carroll County, 194 Fed. 593, the Court passed upon the same type of question involved in this action and there said:

> "This is a suit in equity against the receiver of a national bank to require him to take from the ratable dividends of other creditors of the bank the requisite amount to pay the County's claim in full. The receiver must make the distribution of the property of this bank in accordance with the provisions of the national banking law. It is the dominant purpose and requirement of that law that, after provision for a redemption of its notes is made, the proceeds of an insolvent national bank shall be equally distributed among its unsecured creditors. So imperative is this provision that it repeals a former act of Congress giving a preference to the United States and annuls a statute of a state giving a preference to deposits of savings banks. (Citing cases). The burden, therefore, is on the sureties to prove clearly that they are entitled on equitable principles to the preference they seek. They proved that the bank took the deposits of the county and of its other depositories in trust for them respectively. But this was not enough. They were also required to prove that these deposits or their proceeds, or a certain part of them, came to the hands of the receiver, for he is liable to cestuis

que trustent to pay trust funds in full only to the extent he receives them. * * * A deliberate consideration of the questions this phase of the case presents and a re-examination of authorities have convinced that these are the rules by which claims of this nature to preferential payments out of the proceeds of the property of an insolvent must be adjudged:

"(1) It is indispensable to the maintenance by a cestui que trust of a claim to preferential payment by a receiver out of the proceeds of the estate of an insolvent that clear proof be made that the trust property or its proceeds went into a specific fund or into a specific identified piece of property which came to the hands of the receiver, and then the claim can be sustained to that fund or property only and only to the extent that the trust property or its proceeds went into it. It is not sufficient to prove that the trust property or its proceeds went into the general assets of the insolvent estate and increased the amount and the value thereof which came into the hands of the receiver. (Citing cases)."

In the case of Lucas County v. Jamison, 170 Fed. 338, quoting from Page 348, the Court said:

"Holding, as I do, that the deposits must have been wrongful and a trust created, I still further hold that the funds must be identified, not by 'earmarks' but traced into the estate, and there now found by an augmentation of the estate. If the alleged trust funds have been dissi-

pated, then the cases are at an end; and with but one single exception such are the facts."

To like effect is the holding in Rorebeck v. Benedict Flour and Feed Company, 26 Fed. (2nd) 440.

In the case of Dickson v. First National Bank of Buffalo, Oklahoma, 26 Fed. (2nd) 411 the question of effect of bank clearances was before the Court and the Court disposed of the question in the following manner:

> "Where accounts of collecting and drawee banks were adjusted and draft for balance given the former when checks were presented for collection, and such draft was forwarded to, and deposited to collecting bank's credit by Federal Reserve Bank, which applied collecting bank's entire balance on its indebtedness to the Reserve Bank, owner depositing checks in bank which forwarded it to collecting bank was not entitled to preference or claim to proceeds on later insolvency, as transaction did not increase its assets available for distribution to creditors but merely decreased its indebtedness to Reserve Bank." (Quoting from Syllabus).

TRUST PROPERTY USED TO MAKE BANK CLEARANCES.

It is held by an overwhelming weight of authority that bank checks or drafts representing trust funds run through a clearing house in settlement of claims held by drawee banks against the insolvent bank do not entitle a claimant to a preference against the insolvent bank or its receiver, where the

balance of clearings is in favor of the drawee banks. In the four transactions set out in Counts III, IV, V, and VI in plaintiffs' complaint the balance of the clearings was against Twin Falls National Bank. In each instance the check which the Twin Falls National Bank had procured from the County Treasurer was used to reduce the claims held by the local banks against the Twin Falls National Bank. The final result was merely reducing the bank's indebtedness. There was no augmentation of the funds in the bank and no augmentation of the funds which ultimately came into the hands of the Receiver. Using trust property to diminish the indebtedness or liability of the bank is not equivalent to adding specific or traceable property to its assets.

In the case of Farmers' National Bank v. Pribble, 15 Fed. (2nd) 175, heretofore cited under Point III of this Brief, it appears that the Farmers' Bank had Pribble's draft on an Elevator Company. The Elevator Company was a customer of the People's National Bank. A clearing was had between the two banks on May 10th, 1924, and the People's Bank held the balance of the clearings on that day. Among the checks delivered to the People's Bank on that day by the Farmers' Bank was the said draft on the Elevator Company. The People's Bank accepted payment by the Elevator Company of the draft. The Farmers' Bank received none of the proceeds of the draft but paid the People's Bank the sum of $115.13 to make the clearance. The Farmers' Bank closed on May 12th, 1924. Pribble sued the Receiver of the Farmers' National Bank to establish a preferred claim. The Court said:

"The legal presumption is that that draft and the other checks and drafts on or against the People's Bank which the Farmers' Bank delivered to the People's Bank on May 10, 1924, through the clearance, were delivered to it to pay, and received by that bank in payment of, the checks which were paid by the checks and drafts the Farmers' Bank delivered to the Peoples Bank, and which that bank accepted in payment thereof. Those checks and drafts, in the absence of plenary evidence to the contrary, and there is none, were paid by the clearance, and none of them or of their proceeds ever came to the receiver's hands in the $6,368.66, (the balance taken over by the receiver) because they had been paid by the clearance on May 10, 1924, two days before the bank closed. The result is that the only effect of the use of the draft of $1,046.89 in the clearance and transaction of May 10, 1924, was not in any way to increase the assets of the Farmers' Bank, but possibly perhaps probably, to diminish its indebtedness or liability by the amount of the draft, and such a reduction of its indebtedness creates no preferential trust or lien on the assets of the insolvent over the claims of its general creditors."

The Court then makes the following succinct statement.

"The argument that the use of a trust fund by an insolvent trustee to diminish its indebtedness is equivalent to the use of it to add specific and traceable property to its assets is fallacious. The indispensable requisite of a trust in cases

of this kind is the ability to take out of the property of the insolvent a traceable, identified part of it, which the insolvent, in violation of its duty as a trustee, has put into it."

In Nyssa-Arcadia Drainage District v. First National Bank, 3 Fed. (2nd) 648, the balance of the clearings was against the insolvent bank and with regard to such a condition, Subdivision 7 of the Syllabus reads:

> "Checks sent to the insolvent bank for collection which after being cleared in usual way resulted in balance against insolvent bank in favor of drawee bank, did not increase funds of insolvent bank and did not entitle owner of checks to priority over other creditors."

And the Court using the words of the trial court said:

> " 'There is nothing to indicate that this amount was separated and kept unmingled with the bank's own money; but, on the contrary, it is conceded that it is undistinguishable from the mass of the bank's own money, and cannot be traced to and identified in the hands of the Receiver. This being so appellant has no better equity than the other creditors of the bank and is entitled to no priority over them."

Other cases on this same point are:

First National Bank v. Williams, 15 Fed. (2nd) 585;

Burnes National Bank v. Spurway, 28 Fed. (2nd) 40.

Questions similar to the principal questions involved in this case have been before the Federal Court many times, where those Courts have dealt with the questions in an exhaustive manner and it appears that the rule has been uniformly adopted by those Courts that the use of a trust fund by the trustee bank to discharge debts or liabilities of the bank does not augment the bank's assets but amounts only to a dissipation of the trust fund which precludes the right of the cestui que trust to follow the same into the assets of the bank's Receiver.

Where trust funds of a third person have actually been traced into the funds of the bank, and it also appears that the bank has made expenditures from the common fund, the law raises the presumption that the bank made the expenditures from its own funds and that the residue in its vaults represents the trust fund or what is left of it but in order to invoke this presumption in his favor, the owner must show that his funds, either directly or by substitution, came into the bank and were commingled with the cash funds of the bank which came into the hands of the Receiver. (Cuttell v. Fluent, 51 Fed. (2nd) 974). Such presumption, however, cannot be raised in this case for the manifest reason that none of the funds of the plaintiffs actually came into the Twin Falls National Bank or into the custody of the Receiver.

CASH ON HAND AT THE TIME OF BANK'S FAILURE.

It is stipulated between the parties to this action

(100) that at all times between the 15th day of January, 1929, and up to and including November 23, 1931, the date the bank failed, the said Twin Falls National Bank had cash on hand in an amount sufficient to pay in full the claims of plaintiffs in this suit and to pay also the claim of the plaintiff in Civil Case Numbered 1729, and that when the Bank failed it had cash on hand in the amount of $7,247.74. However, inasmuch as no funds of the plaintiffs ever came into the Twin Falls National Bank and such sum or sums of money as were on hand between January 15, 1929 and the date of its closing did not include funds belonging to the plaintiffs the stipulation is in no way helpful to the plaintiffs.

V.

THE ALLOWANCE AND PAYMENT OF CLAIMS AGAINST THE ASSETS OF A NATIONAL BANK IN THE HANDS OF A RECEIVER ARE GOVERNED BY FEDERAL LAWS AND THE DECISIONS OF THE FEDERAL COURTS.

See Act of Congress (U. S. C. A. Title 12, Sec. 194; R. S. Sec. 5236).

In the case of Dickson v. First National Bank of Buffalo, Oklahoma, 26 Fed. (2nd) 411 the Court said:

> "The issue in this case is to be determined by resort to the principles of general commercial law, as defined by the Federal Courts, independent of the State Law on the subject."

In the case of Empire State Surety Company v. Carroll County, 194 Fed. 593, the Court said:

> "The Receiver must make the distribution of the property of this bank in accordance with the provisions of the National Banking Law."

Accordingly, the case of Kansas State Bank v. First State Bank, (Kan.) 64 Pac. 634, relied on by Judge Cavanah as authority for his decision in this case (122) cannot be regarded as reliable authority for determination of the questions involved herein. It is evident from a study of the decisions emanating from the state courts that there is a great variety of holdings on the question of preferred or trust claims and while as was said in Cuttell v. Fluent, 51 Fed. (2nd) 974:

> "The decisions of the state courts are always persuasive, instructive and respected, they are not conclusive."

Hence, where a rule has been so uniformly established by an unbroken current of authority in the Federal Courts as the rule contended for by this defendant, it seems unnecessary to resort to the decisions of the state courts for support.

OTHER CASES CITED IN MEMORANDUM OPINION.

Judge Cavanah in reaching his conclusion also relied upon and cited Merchants National Bank v. School District, 94 Fed. 705, and Allen et al v. United States, 285 Fed. 678.

These cases are distinguishable from the instant case. The facts in those cases are not analogous to the facts in this case. In the Merchants National Bank case the funds in question were deposited in

the bank in a special deposit for a specific purpose known to the bank officials. In his opinion in that case Judge Gilbert said,

> "The officers of the bank knew the $13,056 so received from Palmer was the proceeds of said refunding bonds, and that the same was applicable only to the redemption of the matured bonds."

On the other hand, in the instant case the Twin Falls National Bank had no knowledge or notice that the orders had been forged; they acted innocently and in good faith and had no notice that the bank might be held accountable for their proceeds. (117). Furthermore, in the Merchants National Bank case the money was actually in the bank and remained in the bank and upon insolvency was turned over to the Receiver. In the instant case the funds in question did not come into the hands of the Receiver.

In the case of Allen v. United States, 285 Fed. 678, the Bank had not been designated as a depository for the United States and the Superintendent had no authority and was positively forbidden to deposit the funds in a bank not designated as a depository for the Government. The officers of the bank at the time they received the deposit knew of the character of the funds and under the Federal Statutes were guilty of embezzlement in knowingly receiving the same, and the Court held in its opinion that the circumstances surrounding the deposit made the bank a trustee ex malefico. Those facts are not similar to the facts in the instant case.

VI.

A CLAIM OR DEMAND BEING PUT IN SUIT AND PASSING TO FINAL JUDGMENT IS MERGED IN THE JUDGMENT AND CANNOT THEREAFTER BE USED EITHER AS A CAUSE OF ACTION OR AS A SET-OFF.

As shown by the complaint in this action plaintiffs instituted separate actions in the State Court against the Twin Falls National Bank for conversion of the moneys obtained by the Bank on forged orders. The issues raised in said actions were fully decided by the Court and judgments rendered in each of said actions in favor of these plaintiffs in the respective amounts claimed, together with accrued interest and costs and disbursements of suit. Thereafter the plaintiff districts presented to the Receiver of the Twin Falls National Bank their claims against the Bank based upon their Judgments and in the identical amounts thereof, each amount being the sum converted, together with interest, costs and disbursements of suit. The claims were disallowed as preferred claims and this suit was accordingly instituted.

It is defendant's contention that any claims or rights of actions which plaintiffs had against the Twin Falls National Bank were merged in the Judgments obtained in the State Court and the issues now before the Court in the present actions are res adjudicata. If the plaintiffs obtained the money judgments against the Bank in the State Court, they no longer had claims for the return of specific property, which is the basis of the present actions to establish preferences. They are now estopped

to raise in this action questions which were or could have been adjudicated in the State Court.

We quote from 34 Corpus Juris 752, Paragraph 1163:

> "Doctrine of Merger. A claim or judgment being put in suit passing to final judgment, is merged or swallowed up in the judgment, loses its vitality, and cannot thereafter be used either as a cause of action or as a set-off unless the statute otherwise provides and this rule applies to a final decree in a court of equity. * * *"

34 Corpus Juris 755, Paragraph 1164 further states:

> "New Liability created by Judgment. As a general rule the recovery of a judgment creates a new debt or liability distinct from the original claim or judgment, and this new liability is not merely the evidence of the creditor's claim but is thereafter the substance of the claim itself."

In 34 Corpus Juris 760-761 we find:

> "A final decree on the merits in a suit in equity will operate as a bar to any further litigation between the same parties on the same cause of action in a court of equity. * * * Conversely, a final judgment on the merits in an action at law will bar any further action between the same parties on the same cause of action in a Court of Chancery."

In the case of Virginia Carolina Chemical Co. v. Kirven, 215 U. S. 252, 30 Sup. Ct. 78, 54 L. Ed. 79 the Court said:

> "It is established that the bar of a judgment in another action for the same claim or demand between the same parties extends to not only what was pleaded or litigated in the first action but what might have been pleaded or litigated. If the second action is upon a different claim or demand the bar of the judgment is limited to that which was actually litigated and determined."

By virtue of the money judgments which were obtained in the State Courts the Twin Falls National Bank became a judgment debtor of plaintiffs.

And where a Receiver of a National Bank is appointed by the Comptroller of the Currency, a judgment rendered after the appointment, in an action begun in a state court before the appointment, is binding upon the Receiver as well as upon the Bank. See Bereth v. Sparks, 51 Fed. (2nd) 441, 80 A. L. R. 909.

Therefore, litigation involving the matters pleaded in plaintiffs' complaint herein was fully concluded by the state court actions. The judgments obtained in the State Courts were binding upon the Bank, and its Receiver and were conclusive as to the plaintiffs and the plaintiffs being judgment creditors were general creditors and are required under the Federal Law providing for a ratable distribution to share in the assets of the insolvent only as general creditors.

For a full discussion of the law applicable to all of the issues involved in this case see Annotation in 82 A. L. R. beginning on Page 46,

CONCLUSION.

Upon the foregoing analysis of the facts of this case and the law applicable to the questions raised herein we submit that the Trial Court should have rendered a Judgment in favor of the defendant.

Respectfully submitted,

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Service of the within brief of Appellant acknowledged by receipt of a true and correct copy thereof this..................day of

...., 1933

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